

cost element included in the direct cost base used to calculate the rates. Accordingly, we uphold the disallowance.

Factual background

The following facts are undisputed. HHSC is the single State agency for Medicaid. Since 1975, the Texas Medicaid State Plan has provided for payment for "authorized medical transportation furnished to eligible recipients as a Title XIX benefit by approved transportation providers both private and public" either based on a negotiated reasonable charge per trip under an "assurance contract" or "based on reasonable charges not to exceed the rates established by the Single State Agency" under a payment-per-trip contract. CMS Ex. A. Prior to 1994, the medical transportation program was operated by the Texas Department of Health under the supervision of HHSC, but in 2004, the Texas legislature revised provisions governing health and human services to give HHSC even greater authority and control, reorganizing the HHSC agencies into four new departments. HB 2292, 78th Legislature, Regular Session, 2003. This legislation also required HHSC to enter into an interagency contract with TX-DOT to "assume all responsibilities of the Texas Department of Health and the [HHSC] relating to the provision of transportation services for clients of eligible programs." *Id.* TX-DOT was authorized to "contract with any regional transportation provider or with any regional transportation broker for the provision of public transportation services." *Id.* This law resulted in transfer of the Medicaid transportation program to TX-DOT. Since 2004, TX-DOT has operated call centers that receive client requests for transportation services, arrange for the transportation on a per-trip basis, and assign a unique confirmation number; TX-DOT then processes claims from transportation contractors based on the confirmation numbers.

On January 18, 2006, the Dallas Regional Office of CMS notified Texas that CMS was deferring the FFP claimed for administrative expenditures for "Indirect Cost - Client" by the HHSC on behalf of TX-DOT. The letter indicated that, through discussions with Texas officials, the Regional Office had discovered that "the State significantly changed their transportation program." TX Ex. B, at B-1. The letter also reported that, during these discussions, TX-DOT staff had stated that "the Federal Highway Administration, the cognizant agency, approved their indirect cost rates for State FY 2006, which is 2.23 percent." *Id.* at B-2. According to the deferral letter, Texas had applied this approved indirect cost rate "to the Medical assistance payments as well as direct costs," based on its belief that Office of Management and Budget (OMB) Circular A-87 authorized it to apply

assistance or an administrative cost. Specifically, 42 C.F.R. § 440.170(a) provides:

Transportation. (1) "Transportation" includes expenses for transportation and other related travel expenses determined to be necessary by the agency to secure medical examinations and treatment for a recipient.

(2) Transportation, as defined in this section, is furnished only by a provider to whom a direct vendor payment can appropriately be made by the agency. If other arrangements are made to assure transportation under § 431.53 of this subchapter, FFP is available as a administrative cost.

For purposes of the Medicaid fee-for-service program, the term "provider" means "an individual or entity furnishing Medicaid services under an agreement with the Medicaid agency" unless the context indicates otherwise. 42 C.F.R. § 400.203. The term "Medicaid agency" or "agency" means the "single State agency administering or supervising the administration of a State Medicaid plan" unless the context indicates otherwise.

Medicaid grants are subject to the cost principles of OMB Circular A-87. 45 C.F.R. §§ 92.4, 92.22. OMB Circular A-87 is now codified in 2 C.F.R. Part 225.

OMB Circular A-87 provides that the total cost of federal awards is "comprised of the allowable direct cost of the program, plus its allocable portion of allowable indirect costs, less applicable credits." Att. A, ¶ D.1. A cost is "allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with the relative benefits received." Att. A, ¶ C.3.a. "Direct costs" are "those that can be identified specifically with a particular final cost objective." Att. A, ¶ E.1. "Indirect costs" are "those: (a) incurred for a common or joint purpose benefiting more than one cost objective, and (b) not readily assignable to the cost objectives specifically benefitted, without effort disproportionate to the results achieved." Att. A, ¶ F.1; Att. E, A.1.²

² As the Circular recognizes, there "is no universal rule for classifying certain costs as either direct or indirect under every accounting system" and a "cost may be direct with respect to some specific service or function, but indirect with respect to the Federal award or other final cost objective." Att. A, (continued...)

OMB Circular A-87 sets out requirements for developing and submitting cost allocation plans and indirect cost rate proposals. Attachment E addresses state and local indirect cost rate proposals.³ Indirect costs are normally charged to federal awards by the use of an indirect cost rate. "Indirect cost rate" is a "device for determining in a reasonable manner the proportion of indirect costs each program should bear" and "is the ratio (expressed as a percentage) of the indirect costs to a direct cost base." Att. E, ¶ B.2. "Base" means "the accumulated direct costs (normally either total direct salaries and wages or total direct costs exclusive of any extraordinary or distorting expenditures) used to distribute indirect costs to individual Federal awards." Att. E, ¶ B.4. Thus, for example, if the direct cost base were \$100,000 and total indirect costs were \$25,000, the indirect cost rate would be 25 percent.

There are several types of indirect cost rates. The rates at issue here are "fixed rates." Fixed rates are determined in advance based on estimates, and then the difference between the estimated costs and the actual allowable costs of the period covered by the rate is carried forward as an adjustment to the rate computation of a subsequent period. Att. E, ¶ B.

There are also several methods for computing indirect cost rates. The "simplified method" may be used where a governmental unit's department or agency has only one major function or where all of its major functions benefit from the indirect costs to approximately the same degree. The provisions for the simplified method state that the "distribution base may be (1) total direct costs (excluding capital expenditures and other distorting items, such as pass-through funds, major subcontracts, etc.), (2) direct salaries and wages, or (3) another base which results in an equitable distribution method." Att. E, ¶ C.2.c. (Emphasis added.) Option 1 is generally referred to as a modified total direct cost base. Where a grantee agency's indirect costs

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¶ D.2. In general, however, costs must be accorded consistent treatment and "may not be assigned to a federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost." Att. A, ¶ C.1.f.

³ Attachment C addresses negotiation and approval of central services cost allocation plans. Attachment D and subpart E of 45 C.F.R. Part 95 address Public Assistance Cost Allocation Plans.

benefit its major functions in varying degrees, use of a "multiple allocation base method" may be required. Att. E, §§ C.1.b. and C.3. Under this method, costs are accumulated into separate cost groupings (that is, pools of expenses that are of like character in terms of the functions they benefit); each grouping (or indirect cost pool) is then allocated to benefitted functions by means of a distribution base which "best measures the relative benefits." Id. The same three options for distribution bases are listed for this method as for the simplified method. Att. E, § C.3.e. In selecting cost elements or related factors for a distribution base, various actual conditions should be taken into account, including whether the cost element or related factor is "common to the benefitted functions during the base period." Att. E, § C.3.c. If conditions exist where a particular award is "carried out in an environment which appears to generate a significantly different level of indirect costs," a "special indirect cost rate" should be developed for that award.

State and local departments or agencies that seek to claim indirect costs under federal awards must prepare indirect cost rate proposals and supporting documentation and timely submit them to the federal agency designated as the "cognizant agency" for that department or agency. Att. E, § D. The cognizant agency reviews the proposal, may negotiate some changes, and then ultimately approves an indirect cost rate (or issues a determination disapproving the proposed rate). Att. E, § E. The Circular provides that "[o]nce a rate has been agreed upon, it will be accepted and used by all Federal agencies unless prohibited or limited by statute." Att. E, § E.1.

The Federal Highway Administration of the Department of Transportation is the cognizant agency for TX-DOT, and the Department of Health and Human Services (HHS), specifically, the HHS Division of Cost Allocation (DCA), is the cognizant agency for the HHSC. 51 Fed. Reg. 552.⁴

⁴ DCA also is responsible for approving public assistance cost allocation plans submitted pursuant to OMB Circular A-87, Attachment D, and 45 C.F.R. Part 95, subpart E. State agencies administering public assistance programs, including Medicaid, must submit to DCA for approval narrative descriptions of their allocation methodologies, so that DCA can evaluate "the appropriateness of the proposed groupings of costs (cost centers) and the related allocation bases." OMB A-87, Att. D, § E.1.

HHS DCA also has government-wide responsibility for implementing OMB Circular A-87. DCA's "Implementation Guide for Office of Management and Budget Circular A-87" (referred to as ASMB C-10) discusses use of "modified total direct costs" as the distribution base for indirect costs. ASMB C-10 explains that modified total direct costs "exclude 'any extraordinary or distorting expenditures,' usually capital expenditures, subawards, contracts, assistance payments (e.g., to beneficiaries), and provider payments." ASMB C-10, at ¶ 6.2.2 (emphasis added).

ASMB C-10 states that the "direct cost base is used to distribute indirect costs to individual Federal awards, i.e., an indirect cost rate must be applied to a direct cost base in order to determine the amount of indirect costs." Id. ASMB C-10 also states that once a rate is "recognized" for purposes of an award, then it may be applied "to the applicable base of the allowable direct costs incurred during award performance." Id. at ¶ 6-16 (emphasis added). In Colorado Dept. of Health Care and Policy Financing, DAB No. 2057 (2006) (cited by both parties here), the Board described how an indirect cost rate is determined and stated that the "resulting indirect cost rate is then customarily applied to a direct cost base comprised of the same cost elements that were used in the base to calculate the indirect cost rate." DAB No. 2057, at 14. In other words, the "applicable" base for purposes of determining the indirect costs allocable to a particular award is one comprised of the cost elements used to determine the rate in the first place.⁵

Analysis

Whether Texas properly included the costs of transportation services in the direct cost base is not determined by whether the costs are administrative costs or medical assistance.

⁵ The reason the Board said in Colorado that the rate is "customarily" applied to the same cost elements is that there are some awards for which the approved indirect cost rate may not be applied to the direct cost base to determine allowable indirect costs because there are regulatory limits on the amount of indirect costs that will be allowed. As ASMB C-10 notes, federal agencies usually determine at the time of an award whether to recognize and use indirect cost rates established for a particular recipient by its cognizant agency. ASMB C-10, at ¶ 6.2.2.

On appeal, Texas noted that in separate disallowances that were the subject of related appeals, CMS had asserted that the payments TX-DOT made for transportation services did not qualify as "medical assistance," and therefore that FFP was available only at the 50 percent rate available for Medicaid administrative costs. According to Texas, if its payments to transportation providers "will be treated as a Medicaid administrative expense rather than a Medicaid provider payment for the purpose of claiming FFP, those payments should also be treated as a Medicaid expense for the purpose of inclusion in the direct cost base to which an indirect cost base is applied." TX Br. at 2-3. In support, Texas cited to the principle in OMB Circular A-87 regarding consistent treatment of like costs as either direct or indirect.

In its response brief, CMS cited the Board decision in the related disallowances, Texas Health and Human Services Commission, DAB No. 2114 (2007), arguing that the Board decision categorized the payments made by TX-DOT as "provider payments" and that it is "clear that the payments at issue in this case are either 'provider payments' or 'assistance payments' as contemplated by both OMB Circular A-87 and its implementation guide (ASMB C-10)." CMS Br. at 7.

We first note that CMS's description of the Board's holding in DAB No. 2114 is not entirely accurate. In that decision, the Board concluded that, prior to June 1, 2006, the transportation services were furnished by "providers to whom a direct vendor payment [could] appropriately be made by the [State] agency" but that, after that date, some of the services were furnished under brokerage contracts, with no direct vendor payment appropriately made from any state agency to the entity that actually provided the service. Having concluded that part of the claims at issue were allowable as "medical assistance" expenditures, under the existing approved plan, the Board upheld the disallowance determinations in part and reversed them in part, in an amount to be determined pursuant to the Board's instructions in its decision.⁶

⁶ The Board further concluded that Texas had established that, under the medical transportation program (even as administered by TX-DOT), recipients had the freedom of choice of providers that was required for Texas to receive FFP in payments for the services at the higher rate for medical assistance expenditures. The decision also noted that Texas may be entitled to an additional lump sum payment of FFP for the services

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Texas did not show that payments from TX-DOT to providers or brokers were included in its approved indirect cost rates for use in charging indirect costs to federal awards.

As indicated above, we are not in this case reviewing an indirect cost rate proposal to determine whether to approve that proposal or to set a different indirect cost rate. It is undisputed here that TX-DOT had, during the period at issue, indirect cost rates that were approved by its cognizant agency. CMS has accepted the approved indirect cost rates as applied to TX-DOT's direct administrative costs, but says that it is not proper to apply those rates to the payments for transportation services because the direct cost base used to compute the rates did not include such payments.

To support its assertion that the direct cost base for TX-DOT's approved rates did not include payments for transportation services, CMS provided a copy of the TX-DOT indirect cost proposal for the period September 1, 2003 through August 31, 2004, that is, State Fiscal Year (SFY) 2004. CMS Ex. D. According to CMS, if the payments for transportation services had been included in the direct cost base used to compute the indirect cost rate, they would have appeared as a "medical/health related" entry in the indirect cost rate proposal, specifically, in the first column of either page 10 or page 11 of the proposal, CMS Exhibit D. CMS Br. at 9.

Texas replies that its Exhibit E "shows that the provider payments **are** included in the direct cost base used in calculating the indirect cost rate under the Approved Indirect Cost Rate Plan for State Fiscal Year 2006." TX Reply Br. at 5 (emphasis in original). Texas does not deny that payments to TX-DOT contractors for transportation services were not included in the historical costs used to calculate the applicable indirect cost rate for SFY 2004, nor does it claim that such costs were included in the base used to calculate the applicable rate for SFY 2005. Instead, Texas maintains that the "medical assistance expenses for transportation were considered part of the direct

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Medicaid recipients, however, they would have been specifically identifiable with the Medicaid program. Such payments are a type of cost normally charged directly to a program, as indicated by the fact that ASMB C-10 mentions provider payments as an element of direct costs that might need to be excluded from modified total direct costs in computing an indirect cost rate.

the fact that the \$124,284,774 reported in the SFY 2006 proposal is \$61,580,016 greater than the amount reported in the SFY 2004 proposal is "primarily attributable to medical transportation expenditures, including provider payments." Id. at 4. Texas cites its Exhibit E as showing that the \$124,284,774 was included in the calculation of the indirect cost rate for SFY 2006.⁹

We conclude that Texas did not show that payments for Medicaid transportation services were included in any direct cost base used to compute TX-DOT's indirect cost rates applicable to the disallowance period. The mere fact that a state may consider estimated cost increases in computing an indirect cost rate based on historical costs does not establish that the SFY 2004 and 2005 rates in fact included estimated payments for transportation services. In fact, the TX-DOT proposal for SFY 2004 indicates that the "Projected Direct Cost" for SFY 2004 for Public Transportation was determined by applying an estimated 6.02% increase to the actual SFY 2002 direct costs for Public Transportation. CMS Ex. D, at D-11. The same percentage increase was used to project increases for other Divisions' direct costs and for indirect costs. Id. Since the same factor was used for all costs, it likely reflects projected inflation. In any event, Texas provided no evidence that the projected increase for Public Transportation related in any way to adding projected costs of transportation services to the actual SFY 2002 expenditures.

With respect to the indirect cost rate for SFY 2006, Texas is correct that the documents show a dramatic increase in the direct costs of Public Transportation used to compute that rate compared to the direct costs used to calculate the SFY 2004 rate. For the following reasons, however, we do not agree with Texas that this demonstrates that payments for transportation services were included in the direct costs used to compute the SFY 2006 rate:

- While Texas asserts that the increase is "primarily attributable to medical transportation services," Texas submitted no evidence to support this assertion. The only information regarding the \$124,284,774 shown by the excerpt from the SFY 2006 indirect cost rate proposal submitted by Texas is that the figure is based on actual expenditures incurred during SFY 2004 and is from

⁹ Texas describes its Exhibit E as "an excerpt from TX-DOT's Approved Indirect Cost Rate Plan for State Fiscal Year 2006, the same document from which Appellant's Exhibit C is an excerpt." TX Reply Br. at 4.

likely have mentioned that it was including this new cost element in the distribution base if it was, in fact, seeking approval for departing from the usual practice of excluding such costs.

To the extent Texas is relying on the Board's decision in University of California to mean that we should defer to Texas's "interpretation" of what was included in the direct cost base, that reliance is misplaced. First, in the University of California case, the Board accepted the interpretation advanced by the University of a statement in the Negotiation Agreement regarding what patient care costs were excluded from the direct cost base because that interpretation was consistent with the wording, structure, and history of the Negotiation Agreement, and because the University had presented evidence showing that the patient care costs at issue had in fact been included in the direct cost base used to compute the indirect cost rate. Here, Texas has not shown that TX-DOT included costs of payments for medical transportation in the direct cost base used to compute the rates for the disallowance period although it is TX-DOT that has access to the information about the costs underlying its indirect cost rate proposal.

Second, Texas has not here pointed to any language in a Negotiation Agreement or an indirect cost proposal that TX-DOT interprets as permitting it to include payments for transportation services in the direct cost base used to distribute indirect costs to federal awards.¹¹

¹¹ Excerpts from the TX-DOT indirect cost rate proposal for SFY 2004 submitted by CMS do indicate that TX-DOT had a "philosophy" that cost recovery of general and administrative costs should be the same "regardless of whether contract or state forces are utilized to do a job or function." CMS Ex. D, at D-9. The transmittal letter for the indirect cost proposal for SFY 2004 therefore states that "'pass-through' expenditures continue to be included in direct cost[s] in our indirect cost plan and indirect cost[s] are distributed to 'pass-through' projects in our accounting system." Id. at D-3. The letter goes on to say, however, that "we do not bill any federal programs for indirect cost on 'pass-through' projects." Id. Thus, even if the payments for medical transportation had been included in the account for Public Transportation Projects and therefore in the direct cost base used to calculate the indirect cost rate for SFY 2004, we question whether the Federal Highway Administration's approval of the rate could reasonably be considered approval for
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Finally, while it appears that the indirect cost rates for TX-DOT were fixed rates, so that carry forwards from earlier periods were permitted, Texas apparently misunderstands the nature of the carry forwards permitted. As shown in the indirect cost rate proposals, the amounts carried forward from prior periods were "Indirect Cost Variances" determined by comparing the total indirect costs that were incurred in each period with the indirect costs "applied." CMS Ex. D, at D-81 to D-84; TX Ex. E. Permitting carry forward of any over- or underrecovery of indirect costs resulting from use of a fixed rate is far different from permitting a state to unilaterally change the direct cost base used to distribute indirect costs among benefitting activities during the rate period.

In sum, we conclude that Texas could not properly apply the approved indirect cost rates for TX-DOT to a direct cost base including payments for transportation services since Texas did not show that such costs were a cost element included in the direct cost base used to calculate the rates.

Conclusion

For the reasons stated above, we uphold the disallowance of \$2,966,601 in FFP Texas claimed as indirect costs of medical transportation services.

_____/s/
Leslie A. Sussan

_____/s/
Constance B. Tobias

_____/s/
Judith A. Ballard
Presiding Board Member

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charging the indirect costs associated with those accounts to federal funds.